

Letter of Findings Number: 04-20120565
Sales Tax
For Tax Years 2009-2011

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ISSUES

I. Sales Tax—Prepaid Phone Cards.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-4-13; IC § 6-8.1-5-1; Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007).

Taxpayer protests the imposition of sales tax on its sales of prepaid phone cards.

II. Sales Tax—Frozen Sandwiches.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-5-20; IC § 6-8.1-5-1; [45 IAC 2.2-5-43](#).

Taxpayer protests the imposition of sales tax on its sales of pre-made frozen sandwiches.

III. Sales Tax—Telephones and Telephone Accessories.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-1-20; IC § 6-8.1-5-1.

Taxpayer protests the imposition of sales tax on its sales of phone accessories.

IV. Sales Tax—Herbal Incense.

Authority: IC § 6-2.5-1-20; IC § 6-2.5-2-1; IC § 6-2.5-5-20; [45 IAC 2.2-5-39](#); Indiana Dept. of State Revenue v. Kimball Int'l Inc., 520 N.E.2d 454 (Ind. Ct. App. 1988); General Motors Corp. v. Indiana Dept. of State Revenue, 578 N.E.2d 399 (Ind. Tax Ct. 1991) aff'd 599 N.E.2d 588 (Ind. 1992); Webster's II New Riverside University Dictionary (1st ed. 1988).

Taxpayer protests the imposition of sales tax on herbal incense.

V. Tax Administration—Negligence Penalty and Interest.

Authority: IC § 6-8.1-10-1; IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

Taxpayer protests the imposition of a ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer operates a gas station and convenience store in Indiana. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer had not collected sales tax on the sales of various items. The Department therefore issued proposed assessments for sales tax, ten percent negligence penalties, and interest for the tax years 2009, 2010, and 2011. Taxpayer protested the assessment of sales tax, penalty, and interest. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

I. Sales Tax—Prepaid Phone Cards.

DISCUSSION

Taxpayer protests the imposition of sales tax on its sales related to prepaid phone cards. Taxpayer states that its vendor told Taxpayer that the price of the card already included all of the state and federal tax, and therefore sales tax did not need to be collected.

All tax assessments are prima facie evidence that the Department's claim for the tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

The first relevant statute is IC § 6-2.5-2-1, which states:

(a) **An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.**

(b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. **The retail merchant shall collect the tax as agent for the state.**

(Emphasis added).

The Department refers to IC § 6-2.5-4-13, which states:

A person is a retail merchant making a retail transaction when a person sells:

- (1) **a prepaid calling service or prepaid wireless calling service at retail;**
- (2) a prepaid calling service authorization number or prepaid wireless calling service authorization number at retail;
- (3) the reauthorization of a prepaid calling service or prepaid wireless calling service; or
- (4) the reauthorization of a prepaid calling service authorization number or prepaid wireless calling service authorization number.

(Emphasis added).

Taxpayer was a retail merchant responsible for collecting the sales tax on the sale of the phone cards under IC § 6-2.5-2-1. Therefore, the prepaid phone cards are clearly taxable under IC § 6-2.5-4-13. Taxpayer has not met the burden of proving the proposed assessments wrong, as required by IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is denied.

II. Sales Tax–Frozen Sandwiches.

DISCUSSION

Taxpayer protests the imposition of sales tax on its sales related to pre-made frozen sandwiches. Taxpayer explains that it does not make the sandwiches in the shop. Taxpayer further explains that it does not sell utensils with the sandwiches, and that if the customer heats up the frozen sandwiches, then Taxpayer will collect sales tax.

The Department again refers to IC § 6-2.5-2-1, which states:

(a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.

(b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state.

IC § 6-2.5-5-20(a) provides that "[s]ales of food and food ingredients for human consumption are exempt from the state gross retail tax." IC § 6-2.5-5-20(b) and (c) state in relevant part that:

(b) For purposes of this section, the term **"food and food ingredients for human consumption" includes the following items if sold without eating utensils provided by the seller:**

...

(2) **Food sold in an unheated state** by weight or volume as a single item.

...

(c) Except as otherwise provided by subsection (b), for purposes of this section, the term **"food and food ingredients for human consumption" does not include:**

...

(5) **food sold in a heated state or heated by the seller;**

(6) **two (2) or more food ingredients mixed or combined by the seller for sale as a single item** (other than food that is only cut, repackaged, or pasteurized by the seller, and eggs, fish, meat, poultry, and foods containing these raw animal foods requiring cooking by the consumer as recommended by the federal Food and Drug Administration in chapter 3, subpart 3-401.11 of its Food Code so as to prevent food borne illnesses);

(7) **food sold with eating utensils provided by the seller**, including plates, knives, forks, spoons, glasses, cups, napkins, or straws (for purposes of this subdivision, a plate does not include a container or packaging used to transport the food)

(Emphasis added).

[45 IAC 2.2-5-43](#)(a) states that:

Sales of food which ordinarily is sold for immediate consumption at or near the premises of the seller are taxable even though such food is sold on a "take-out" or "to go" order basis and is actually bagged, packaged, or wrapped and taken from the premises of the seller. Where and when the customer actually eats such food is immaterial. Accordingly, sales through a grocery store, salad bar, bakery, or delicatessen and by restaurants, cafeterias, lunch counters, drive-ins, roadside ice cream and refreshment stands, fish and chip places, fried chicken places, pizzerias, food and drink concessions, or similar facilities, of meals, sandwiches, hamburgers, hot dogs, french fries, fried chicken, fish and chips, pizza, potato salad, cole slaw, popcorn, sundaes, cones and cups of ice cream, milk shakes, soft drinks, and similar ready-to-eat food and beverage items are taxable regardless of whether sold by such establishments for consumption on the premises or on a "take-out" or "to go" basis.

If the sandwiches are sold frozen, are not prepared at or near Taxpayer's store, and they are not sold with utensils, then the sandwiches would indeed be exempt from sales tax. However, Taxpayer has not provided any documentation or information to substantiate that this was the case, other than its own assertions. Therefore, Taxpayer has not met the burden of proving the proposed assessments wrong, as required by IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is denied.

III. Sales Tax–Telephones and Telephone Accessories.

DISCUSSION

Taxpayer protests the imposition of sales tax on sales of cellular telephones and accessories. In its protest letter, Taxpayer claimed that it does not sell telephone accessories. Taxpayer then said that the vendor instructed Taxpayer that the price included the state and federal tax. Therefore Taxpayer did not collect tax because they believed they were complying with the law.

However, Taxpayer at the hearing again claimed that it does not sell these items at its store, but went on to say that it was actually selling gift cards. Taxpayer claims that these items were actually gift cards, and believes

that the cashier(s) rang up the items incorrectly. Taxpayer claims that the buttons for both are near each other on the register.

The Department again refers to IC § 6-2.5-2-1, which states:

(a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.

(b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state.

[45 IAC 2.2-4-1](#)(a) provides that "[w]here ownership of tangible personal property is transferred for a consideration, it will be considered a transaction of a retail merchant constituting selling at retail."

Taxpayer has not provided any documentation or information to substantiate that Taxpayer was actually selling gift cards, other than its own assertions. Taxpayer has not met the burden of proving the proposed assessments wrong, as required by IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is denied.

IV. Sales Tax—Herbal Incense.

DISCUSSION

Taxpayer protests the imposition of sales tax on its sales related to herbal incense. Herbal incense is a product that is sold in individual packets, and is a combination of herbs and botanicals mixed with chemicals. Herbal incense is ingested or smoked using rolling papers or pipes.

The Department again refers to IC § 6-2.5-2-1, which states:

(a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.

(b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state.

IC § 6-2.5-5-20(a) provides that "[s]ales of food and food ingredients for human consumption are exempt from the state gross retail tax." IC § 6-2.5-1-20 defines "food and food ingredients" as:

"Food and food ingredients" means substances, whether in liquid, concentrated, solid, frozen, dried, or dehydrated form, that are sold for ingestion or chewing by humans and that are consumed for their taste or nutritional value. The term does not include alcoholic beverages, candy, dietary supplements, tobacco products, or soft drinks.

Therefore, whether or not an item qualifies for the exemption provided by IC § 6-2.5-5-20 is a fact-sensitive issue. In applying any tax exemption, the general rule is that "tax exemptions are strictly construed in favor of taxation and against the exemption." *Indiana Dept. of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988). The taxpayer claiming exemption has the burden of showing the terms of the exemption statute are met. *General Motors Corp. v. Indiana Dept. of State Revenue*, 578 N.E.2d 399, 404 (Ind. Tax Ct. 1991) *aff'd* 599 N.E.2d 588 (Ind. 1992) (Internal citations omitted). Additionally "[e]xemption statutes are strictly construed because an exemption releases property from the obligation of bearing its fair share of the cost of government." *Id.*

Taxpayer argues that herbal incense is a "spice," and therefore it is exempt from the sales tax because it is a food or food ingredient. [45 IAC 2.2-5-39](#) provides that "spices" would be considered a nontaxable food or food ingredient. However, the "herbal incense" would not be considered a "spice." A "spice" is "a pungently aromatic vegetable substance, as cinnamon or nutmeg, used to flavor foods or beverages." *Webster's II New Riverside University Dictionary* 1119 (1st ed. 1988). The herbal incense is not used to flavor food or beverages, nor is it a vegetable substance.

Further, the "herbal incense" is also not "consumed" by Taxpayer's customers. To "consume" means "to eat or drink up." *Webster's II New Riverside University Dictionary* 303 (1st ed. 1988). The herbal incense is smoked and inhaled, not eaten or drunk.

For these reasons, Taxpayer has failed to meet its burden of proof under IC § 6-8.1-5-1(c) to show that the herbal incense would be exempt from sales tax.

FINDING

Taxpayer's protest is denied.

V. Tax Administration—Negligence Penalty and Interest.

DISCUSSION

The Department issued proposed assessments and the ten percent negligence penalty for the tax years in question. Taxpayer protests the imposition of penalty and interest. Taxpayer makes these claims based on reasons of equity.

At the outset, the Department notes that it is not allowed to waive interest, as provided by IC § 6-8.1-10-1(e).

The Department refers to IC § 6-8.1-10-2.1(a), which states in relevant part:

If a person:

...

(3) incurs, upon examination by the department, a deficiency that is due to negligence;

...
the person is subject to a penalty.

The Department refers to [45 IAC 15-11-2\(b\)](#), which states:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

[45 IAC 15-11-2\(c\)](#) provides in pertinent part:

The department shall waive the negligence penalty imposed under [IC 6-8.1-10-1](#) if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

In this case, Taxpayer incurred a deficiency which the Department determined was due to negligence under [45 IAC 15-11-2\(b\)](#), and so was subject to a penalty under IC § 6-8.1-10-2.1(a). Taxpayer has not established that its failure to pay the deficiency was due to reasonable cause and not due to negligence, as required by [45 IAC 15-11-2\(c\)](#).

FINDING

Taxpayer's protest is denied.

CONCLUSION

Taxpayer's protest is denied.

Posted: 06/26/2013 by Legislative Services Agency

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